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SUBJECT: DUBAI REAL ESTATE MARKET, PART ONE: IMPROVING LEGAL ENVIRONMENT

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DUBAI 00000287 001.2 OF 005

Sensitive but Unclassified; please protect accordingly.

¶1. (SBU) Summary: With the opening of land sales to non-nationals through freehold sales in 2002 (refs A, B and C), the Dubai construction and real estate markets began an unprecedented boom phase. By 2006, the real estate and construction sectors comprised roughly 16 percent of total Dubai GDP. While official 2007 GDP numbers are not yet available, the sector's continued surge has repeatedly confounded analysts who had predicted the market's peak in 2007, then adjusted their projections to peak in 2008, then 2009, and now 2010 and beyond. However, as the US housing market so dramatically demonstrates, what goes up, must eventually fall, and given recent worldwide trends, a review of the Dubai real estate market and its potential for a hard versus soft landing is warranted. This is the first in a series of cables to examine the driving factors behind the real estate boom and their potential long-term implications for the Dubai economy.

¶2. (SBU) Summary continued: The UAE constitution is silent on the issue of land ownership; laws governing sale of land are under the jurisdiction of the individual emirates. Historically, the local ruling family either "gifted" or "granted" land to nationals, while expatriates were effectively excluded from land ownership. In May 2002, Dubai changed the paradigm, becoming the first emirate to give permission for non-nationals to buy "freehold" properties on government-designated pieces of land (currently there are about 30 such designated areas in Dubai). At "freehold" inception, there were vast gaps in the legal framework, for example in the areas of: land and title registration, mortgage-holder rights, communal rights, inheritance and residency rights. Early investors purchased property with the simple hope that these issues would eventually be resolved. Since 2002, many of the gaps in the regulatory environment have been either filled or are in the process of being rectified; the "wild west" real estate market of Dubai is progressing gradually towards one regulated by a more clearly defined rule of law. The following provides an update on previous reporting (ref A) on advances in the Dubai real estate legal environment. End summary.

Real Estate Regulatory Agency

¶3. (U) Probably one of the most important developments on the

Dubai Real Estate scene was the formation of the Real Estate Regulatory Agency (RERA) in 2007, in the words of RERA's CEO Marwan bin Ghulaita, "to ensure the safe landing" of Dubai's property market. RERA, a nodal agency of Dubai Land Department (DLD), is tasked with formulating property-related regulations and policies; oversight and registration of developers, brokers and agents; oversight of property marketing and advertising; authentication and registration of property sales; and rental agreements.

¶4. (SBU) Developers, contractors, brokers and consultants unanimously told Pol/Econoff they believe the potential for RERA is substantial and its CEO is committed to developing a stable market, but also that the agency is too small, with inexperienced staff and too many areas of overlapping/conflicting responsibility with Dubai Municipality. One broker commented that while RERA is creating regulations, it does not yet have the ability to inspect for and enforce compliance. Or as another contact put it, "RERA doesn't yet have enough of the right people doing the right things". In effect, RERA is playing catch-up, attempting to regulate an already over-heated market without all the necessary resources. Whether it succeeds or fails may be primarily driven by its ability to quickly obtain the needed expertise and staff.

Title Registration

¶5. (U) Until April 2006, with the enactment of the Title Registration Law (Dubai Law Number 7), non-national freehold purchasers and leaseholders were not permitted to register land title or leasehold with the DLD (or its new nodal agency, RERA as of 2007), and were thereby effectively excluded from the full range of legal protections and transaction rights normally

accrued to land owners. Without the ability to legally register title, unscrupulous (or even simply disorganized) sellers could sell the same plot/unit multiple times to different owners. Requiring registration of title at the time the property is fully paid for and delivered into the buyer's hands was an important first step for Dubai's real estate regulatory regime. Equally important, the Title Registration Law established that the DLD's Land Register (now RERA's Land Registry) is the final arbiter of land ownership.

¶6. (U) In Dubai, money frequently changes hands prior to final delivery of the land, unit or building (i.e., secondary developers contract for land with the three Dubai para-statal master developers before the land is ready for turnover, and buyers contract with building developers for houses/apartments/offices that have yet to be built -- referred to as "off-plan" or buying based on the 'planned' development). While not yet required by law (although a legal framework is in the works), in June 2008 RERA started requesting secondary developers to voluntarily register all land plot acquisitions from master developers, whether paid in full or not. This was the direct result of several earlier cases where master developers had pulled back from a land sale to a secondary developer, after the secondary developer had already sold off-plan units to the public. Moving further down the transaction stream, RERA may request developers register all off-plan unit sales, effectively creating a database of all units under development and their respective purchasers -- thus attempting to eliminate problems with multiple investors being sold the same off-plan unit and concurrently starting a comprehensive database of off-plan ownership history. Legislation of both initiatives would provide substantial peace-of-mind to purchasers of Dubai's off-plan developments.

Escrow

¶7. (U) Prior to December 2007, developers could sell one project off-plan and then use the sales proceeds to fund a different project's construction, resulting in a domino style funding pattern. Recognizing the inherent risks of such a strategy, Dubai enacted "The Escrow Law" (Dubai Law Number 8, effective June 2007, with a December 2007 compliance deadline), which mandates that all monies paid towards a specific project must be deposited into a guaranteed account directly linked to that project. Funds may only be released from the account to the developer upon completion of project milestones, with the final ten percent withheld from release until one year after final handover to the purchasers/investors (the final payment is to ensure initial defects are repaired). All developments where off-plan sales have not yet begun are now required to set-up the escrow account before sales commence. For existing developments already sold but not yet completed at the time the law was enacted, a stepped compliance process was instituted. As of July 2008, RERA's website states 571 projects have associated escrow accounts.

¶8. (SBU) Since the vast majority of Dubai real estate has historically been sold off-plan, the enactment of Escrow regulations substantially removes the financial risk to investors in Dubai developments. Not surprisingly, since the law's enactment, developers in Dubai are moving away from a one-time, off-plan sale of the entire development, and are instead parceling out sales over time as the project matures. Many of the larger developers are also focusing expansion efforts on non-UAE markets (such as Africa, MENA and Eastern Europe) that do not have similar escrow requirements, effectively maintaining domino financing, just moving the dominos, and risk, overseas.

Condominium "Strata" Law

¶9. (U) Most of Dubai's residential developments are planned master-communities (either high-rise buildings or villa/townhome developments) with extensive common areas (such as swimming pools, recreation facilities, gardens, roads, as well as internal shared structural elements in high-rise buildings). However, prior to the Dubai Condominium "Strata" Law (Dubai Law Number 27, of December 2007, effective April 2008), there was

little legal clarity regarding the rights and responsibilities of developers and investors/homeowners in these communities. While RERA and DLD are still finalizing the underlying implementing regulations of the law (hence, there is still some confusion as to how the law will be interpreted and enforced), on a broad level it provides a legal basis for homeowner's associations, while holding developers liable for structural defects for a period of 10 years and mechanical, electrical, sanitary and plumbing defects for one year. For off-plan investors, the new law provides assurances that the property delivered will meet minimum structural and mechanical standards (or that developers will be required to rectify the situation). In addition, investors/homeowners will be able to form their own association to monitor enhancements and repairs to the property, and not be left at the mercy of developers for the ongoing maintenance of their investment.

Broker's Law

¶10. (U) In the early days of Dubai real estate, anyone could call themselves a broker or an agent. There was no required

training, testing or licensing. With the 2006 Brokers Registration Law (Dubai by-law Number 85), registration of brokers is now legally required (although there is some ambiguity on the requirements for agent registration). While estimates vary widely as to the true number of real estate brokers and agents in Dubai, RERA's website lists 1,632 registered brokerage companies (comprising roughly 4,000 agents). Local brokers and agents claim there are still many unregistered practitioners, but proposed changes in RERA regulations will limit key real estate functions (such as access to RERA-mandated sales and rental contracts, registration of sales, etc.) to registered agents, effectively driving out the unlicensed/informal agents.

¶11. (SBU) Nonetheless, training and testing of brokers and agents are still in their infancy; RERA only recently began offering a voluntary training course (according to one broker, the course is costly at approximately $2500 per agent, and mandatory testing is still just an idea on the distant horizon. In sum, while the concept of creating a licensed and regulated sales system is taking hold, the actual implementation and enforcement elements are still missing.

Tenancy Law

¶12. (U) Since property ownership only recently became a reality for Dubai's expatriate population (which constitutes over 80% of all residents), the vast majority of Dubai residents still rent their homes and apartments. Dubai rents have skyrocketed over recent years; according to Al Mal Capital (a local investment house), Dubai rents rose more than 40 percent from June 2007 to June 2008 (rents and property prices will be addressed septel). Intending to modulate the rental market, Dubai passed the "Tenancy Law" (Dubai Law Number 26 of 2007) which became effective in February 2008. The law gives teeth to previous "rent caps" instituted in 2006 (under the 2006 rent cap, existing rental contracts could only be renewed at a 15 percent increase on the current rate, in 2007 the cap fell to 7 percent and in 2008 the cap on rent increases is 5 percent). Under the law, tenancy contracts must be in writing (RERA's CEO says the agency will soon require standardized tenancy contracts) and registered with RERA. Contract renewal disputes must be referred to the Dubai Municipality's Rent Court. The Rent Court and other government entities are forbidden from considering any matter arising from a tenancy contract not registered with RERA. A key aspect of the law makes it extremely difficult for landlords to remove tenants from a property (the landlord must prove the property will revert to his/her personal use or will undergo a major renovation).

¶13. (SBU) Opinions vary as to the efficacy of the Tenancy Law and the Rent Court. Common lore has it that landlords get around the rent caps at court by claiming personal use or renovation and then simply rent out the property at higher rates once the tenant has departed. However, in multiple discussions with brokers, agents, contractors and developers, Pol/Econoff has heard numerous stories attesting to the fairness and

toughness of the Rent Courts, their "tenant friendliness" and their determined enforcement of the law and rent caps. (Common lore, in this instance, may simply reflect long-held perceptions on the part of tenants or lack of understanding of their rights under the law.)

Unresolved Issues in Dubai Real Estate Law

¶14. (U) One of the bigger holes in Dubai's real estate law is

the lack of any law regulating mortgages or a legal framework to govern the rights and obligations of mortgage providers and holders. According to Amlak (a major mortgage provider), mortgages have only penetrated 1.2 percent of the eligible base in the UAE (the mortgage industry will be addressed septel). So far, many of the housing units sold have been to investors and speculators (who typically eschew mortgage financing). However as off-plan developments move towards completion, Dubai is seeing more and more end-users move into the developments, and these consumers are prime mortgage candidates. Lack of regulations surrounding mortgages and the associated lack of foreclosure laws could pose a substantial long-term problem for Dubai's Real Estate and Financial markets. On a positive note, the Dubai Government has recognized the shortfall and is currently reviewing a draft mortgage law that could be enacted within the year.

¶15. (U) A second hole in Dubai real estate law concerns rights of inheritance of freehold properties. The current law is unclear as to whether local Sharia law takes precedence over personal wills (often dictated and probated in the foreign resident's home nation) on matters of real estate. With increasing numbers of expats making significant real estate purchases, many of them for retirement purposes, the laws of inheritance must eventually be clarified.

¶16. (U) A key selling point initially for many overseas investors in free-hold properties was the promise of a residency visa attached to the purchase (the visa was to be sponsored by the master developer and was a key incentive to nationals of Iran, Pakistan and other less stable countries looking for a potential bolt-hole should things turn rough at home). However, recent events indicate that expectations of a visa were premature. In June, as major developments neared completion and handover to their owners, press coverage indicated that the associated residency visas were not forthcoming (since visas are granted by the UAE Department of Immigration, a federal entity, Dubai was somewhat over eager in promising visas to property purchasers). While subsequent press suggest that Nakheel, Emaar and Dubai Properties (the three Dubai government approved master developers) appear to have devised solutions to the issue (nfi) for existing developments (vital to maintaining the Brand Dubai image at home and abroad), new developments are no longer touting a residency visa as part of the purchase agreement, and RERA has made a forceful public stand disassociating purchase of free-hold property with visa access.

COMMENT

¶17. (SBU) Basic economic theory suggests that the transition from an unregulated free-for-all to a structured legal environment is a common sign of a market's growing maturity. While early investors are typically less sensitive to risk, market movement along the growth curve brings less risk-prone buyers into the arena (thereby pushing up total demand for the product); these new buyers require additional guarantees and safeguards in return for their participation. This phenomenon is what Dubai's real estate market is currently experiencing. The dramatic effort to establish legal frameworks since the introduction of free-hold sales in 2002 has been a necessary underpinning of the market, increasing investor confidence. While still relatively new and untested, Dubai now has the beginnings of a credible regulatory framework to encourage additional investors to consider buying into the Dubai dream. It remains to be seen whether the laws on the books will find adequate enforcement by the Dubai Land Department and its Real Estate Regulatory Agency, but at a minimum they demonstrate that

the emirate is endeavoring to move along the maturity curve.

Subsequent cables will address the supply and demand for Dubai residential and commercial real estate, the mortgage market and long term implications for Dubai. End comment.
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